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Ernst disappoints its tech clients

SILICON VALLEY COMPANIES DISAGREE WITH FIRM'S OPTION-EXPENSING OPINION

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Some of Silicon Valley's largest technology companies are disappointed that accounting firm Ernst & Young flip-flopped its opinion on expensing employee stock options, but none appears upset enough to start looking for a new accounting firm.

Ernst & Young audits the finances of 46 of Silicon Valley's 150 largest companies -- 31 percent -- second only to PricewaterhouseCoopers, which represents 55 of the top 150.

For years, Ernst & Young maintained a position that options should not be counted as a cost to the companies that grant them, sharing the opinion of many of its Silicon Valley clients. Expensing options would have the effect of increasing costs and reducing earnings. Stock options have been a key part of compensation for many Silicon Valley tech companies.

But in a letter this week, the firm told the Financial Accounting Standards Board, the agency that makes the rules for accounting professionals, that options should be reflected as an expense in financial statements.

Intel, among Ernst & Young's technology clients, expressed the most annoyance with the firm's reversal. Intel was one of 33 companies that last year agreed to voluntarily disclose more information on stock-option grants as a way of avoiding any new rules that might require them counted as an expense.

``We're a bit disappointed that they would take a controversial position without first consulting with their clients,'' said Intel spokesman Chuck Mulloy, adding that Intel doesn't believe the change is warranted. ``We disagree. We don't think it's appropriate.''

Hewlett-Packard declined to comment on Ernst & Young's reversal but re-stated its longstanding position opposing the expensing of employee stock options.

During an earnings call last year, HP Chief Executive Carly Fiorina said one of her company's biggest concerns is that there are no clear accounting rules on how to value the expense of options consistently across companies.

``Because the economic cost of options is almost always different from the calculated period expense, the result can distort operating performance,'' she said at the time. ``Until there is clear accounting guidance and the rules have been established, it is our belief that reporting results that include option expense adds complexity and confusion to evaluating business performance.''

Intel insists that the current method for reporting stock options -- usually excluded from calculating the bottom line but noted as a footnote on company annual reports -- is sufficient. Even the Ernst & Young letter to the Financial Accounting Standards Board noted that calculating the impact of stock options on earnings reports is no easy task.

``There is no foundation for reporting a price on an option where you don't know the future price,'' Mulloy said.

The federal accounting board and its international counterpart have been trying to develop accounting standards that are compatible for both domestic and international companies. The boards have asked industry participants to comment on proposals to change current accounting methods.

Earlier this month, a bipartisan group of 40 members of congress -- including three Silicon Valley Democrats -- voiced a ``strong opposition to any proposal'' that would require companies to treat stock options as an expense.

The letter, co-authored by Rep. Anna Eshoo, D-Palo Alto, and signed by San Jose Democratic legislators Zoe Lofgren and Mike Honda, contends that there is no reliable method for valuing stock options and that expensing them ``would effectively destroy'' plans that dole out options to workers.

With its actions this week, Ernst & Young has taken the lead on what has been a divisive issue. But simply endorsing a change isn't enough reason to break off a business relationship with Ernst & Young, some clients say.

Kathy Durr, spokeswoman for Juniper Networks of San Jose, said the company has been with Ernst & Young since its inception and has no immediate plans to alter that relationship.

``They've been a good partner over the years,'' she said.

Over at JDS Uniphase in San Jose, executives realize that the issue is controversial and have met with Ernst & Young to discuss it.

Based on those discussions, it's clear that determining stock-option value remains a big problem.

``Ernst and Young recognizes that there is difficulty and not an accepted methodology for value and that's huge,'' JDS spokesman Gerald Gottheil said. ``This is something that people need to wrestle with.''

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